

The Meeting of the Advisory Committee on Community Banking

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

November 3, 2016 – 9:05 A.M.

The meeting of the FDIC Advisory Committee on Community Banking (“Committee”) was called to order by Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation (“FDIC”) Board of Directors.

The members of the Committee present at the meeting were: Tiffany Baer Paine, President and Chief Executive Officer (“CEO”), Security Bank USA, Bemidji, Minnesota; Richard T. Beard, President and CEO, People’s Utah Bancorp, American Fork, Utah; Adriana M. Boeka, President and CEO, America’s United Bank, Glendale, California; Asif Dakri, Vice Chairman and CEO, Wallis State Bank, Houston, Texas; Christopher W. Emmons, President and CEO, Gorham Savings Bank, Gorham, Maine; David J. Hanrahan Sr., President and CEO, Capital Bank of New Jersey, Vineland, New Jersey; Jack A. Hartings, President and CEO, The Peoples Bank Corp., Coldwater, Ohio; Howard Chandler, President and CEO, Liberty Bank, Middletown, Connecticut; Danny J. Kelly, President and CEO, Hometown Bank of Alabama, Oneonta, Alabama; Arvind A. Menon, President and CEO, Meadows Bank, Las Vegas, Nevada; Mary Ann Scully, President and CEO, Howard Bank, Ellicott City, Maryland; Gwen M. Thompson, President and CEO, Clover Community Bank, Clover, South Carolina; John M. Tolomer, President and CEO, The Westchester Bank, White Plains, New York; and Joseph W. Turner, President and CEO, Great Southern Bank, Springfield, Missouri.

Roger Busse, President and CEO, Pacific Continental Bank, Eugene, Oregon, was absent from the meeting.

Corporation staff who attended the meeting included: Steven O. App, Julie V. Banfield, Shannon M. Beattie, Luke H. Brown, Richard A. Brown, Kitty Chaney, Christine Davis, Debra A. Decker, Patricia B. Devoti, Willie B. Donaldson, Doreen R. Eberley, Diane Ellis, Jared Fronk, Janet R. Gordan, Shannon N. Greco, Matthew Green, Nicholas Kazmerski, Matthew Kepniss, Christopher Lucas, Jonathan N. Miller, Rae-Ann Miller, Emmanuel Monteau, Mark E. Pearce, Floyd Robinson, Claude A. Rollin, Barbara A. Ryan, Philip A. Shively, Michael E. Spencer, Gordon S. Talbott, Rachel A. Ursery, James C. Watkins, and Angela A. Wu.

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William A. Rowe, III, Deputy to the Chief of Staff and Liaison to the FDIC, Office of the Comptroller of the Currency was also present at the meeting.

After calling the meeting to order, Chairman Gruenberg began by introducing the new members on the panel. Richard Beard, the President and CEO of People's Utah Bancorp in American Fork, Utah, Adriana Boeka, the President and CEO of America's United Bank in Glendale, California, Asif Dakri, the Vice Chairman and CEO of Wallis State Bank, Houston, Texas, David Hanrahan, President and CEO of Capital Bank of New Jersey, Chandler Howard, President and CEO of Liberty Bank in Middletown, Connecticut, Danny Kelly, President and CEO of The Hometown Bank of Alabama in Oneonta, Alabama, Tiffany Baer Paine, President of Security Bank USA in Bemidji, Minnesota, and Joseph Turner, President and CEO of Great Southern Bank of Springfield, Missouri.

Chairman Gruenberg next went over the Agenda. First, the Chairman indicated that in the morning session, there would be a brief update on the FDIC's Community Banking Initiative given by Doreen Eberley, Director, Division of Risk Management Supervision ("RMS"), Mark Pearce, Director, Division of Depositor and Consumer Protection ("DCP"), and Diane Ellis, Director, Division of Insurance and Research ("DIR"). Following that, FDIC senior staff in RMS provided background on outreach meetings that the FDIC had recently posted to assist groups interested in forming de novo institutions. Chairman Gruenberg noted that de novo bank formation has been of particular interest and thus far, the FDIC has hosted two outreach sessions, one in San Francisco and another in New York, and there is a third session in Atlanta planned for later that month. Chairman Gruenberg mentioned that the FDIC is planning additional de novo outreach meetings in other parts of the country in 2017.

Chairman Gruenberg also mentioned that the FDIC recently hosted a roundtable discussion with representatives of colleges and universities that have undergraduate and graduate banking programs designed to train the next generation of community bankers. The Chairman commented that there is room for more collaboration between banks and academic institutions to educate and train the next generation of community bankers.

Next, Chairman Gruenberg indicated that there would be an update on the current status of the Deposit Insurance Fund and the FDIC assessment rates. Following that, the Chairman indicated there would be a discussion concerning recent developments in consumer protection and compliance. Following the lunch break, Chairman Gruenberg stated that there would be a discussion on recent developments in risk management supervision policy, including the recent guidance on third-party lending and interagency community bank Call Report proposal and an update on the regulatory review process being conducted pursuant to the Economic Growth and Regulatory Paperwork Reduction Act ("EGRPRA"). Finally, Chairman Gruenberg indicated that there would be an open roundtable concerning any general issues and concerns members would like to discuss. Chairman Gruenberg then turned over the program to his Chief of Staff, Barbara Ryan, to introduce the first session.

Barbara Ryan then introduced Diane Ellis, Director, DIR, and Jared Fronk, Financial Economist, DIR, to make a presentation on the Community Banking Initiative; specifically a preview of a paper they are working on that analyzes core profitability at community banks. Following that, Ms. Ryan indicated that Doreen Eberley, Director, RMS, and Mark Pearce, Director, DCP, would provide an update on several other initiatives underway as part of the Community Banking Initiative.

Ms. Ellis provided some general background of the role of DIR, which involves conducting research on issues relevant to community banks and understanding the trends involved in community banking. She next introduced Jarod Fronk to provide a high level overview of their study and research concerning core profitability of community banks from 1985-2015.

Mr. Fronk began by explaining that the research study focused on core profitability of banks from 1985-2015, in particular, the state of core profitability of banks and their intrinsic ability to make profits. Mr. Fronk explained, that once all of the macroeconomic factors which banks have no control over are removed, the study looks at how well they would have performed. He went on to explain that, on the economic side, there are four separate variables: state level unemployment, state level gross domestic product (“GDP”) growth, the spread, and interest rates. Mr. Fronk explained that the study did not aim to analyze what core profitability or structural profitability consists of. He stated that core profitability consists of things like regulation, business practices, loan composition, portfolios, entry and exit, and non-bank competitors.

Mr. Fronk then used a slide deck to illustrate points from the study, ending with a summary of several key conclusions. First, he explained that over the full 30 year sample, about half of the observed deviation in community bank ROA from core profitability can be explained by economic factors. The other half, he stated, can be attributed to competition from non-bank actors, competition among community banks, entry and exit, regulation, and other structural factors. In the period since the 2008 recession, Mr. Fronk further explained, 80 percent of the deviation in observed ROA from core profitability can be attributed to economic factors, with only about 20 percent remaining to be explained by structural changes. Mr. Fronk explained how this reflects the severity of the recession and its impact on community bank profitability. Mr. Fronk concluded by explaining that while core profitability was on the decline for most of the sample, the 2008 recession forced structural changes in bank operations and industry composition which have reversed this trend and actually led to a recent rise in core profitability.

Member Howard asked if the study looked at Mutual Bank performance compared to the others to which Mr. Fronk indicated it did not, but that he would look further into it. Member Hartings stated that it would be interesting to see what the banking industry has done with higher capital levels. Committee member Hartings further commented that it would be interesting to look at return on investment (ROI) as well. Member Dakri asked if there is a way to segregate the weaker banks to which Mr. Fronk answered that the study did look at non-failing banks.

Ms. Ryan then introduced Ms. Eberley and Mr. Pearce to provide an update on other aspects of the Community Banking Initiative. Ms. Eberley began by providing an overview of how the Division of Risk Management Supervision has approached the Community Banking Initiative. Ms. Eberley explained that the approach has been to ensure that the FDIC is carrying out supervision in a way that adds value to the industry and minimizes burden without sacrificing safety and soundness. She reported that since 2012, RMS has reviewed various activities such as streamlining the examination process. Ms. Eberley provided several examples including reviewing pre-examination request lists and providing technical assistance via Directors' College videos and topical videos on various issues and interests. Ms. Eberley also mentioned that RMS has been focused on providing resources to institutions such as the Directors' Resource Center on the FDIC webpage located under "Community Banking Initiative."

Ms. Eberley next mentioned that the Community Bank Resource Kit had been mailed out. Ms. Eberley welcomed any feedback on content that might be useful to consider adding to the kit as well as topics for new videos. Ms. Eberley next mentioned that RMS did issue a Supervisory Insights Journal article about the deposit insurance application process, and is currently working on a handbook for proposed organizers of de novo institutions, to guide them through the application process.

Mr. Pearce then provided an overview of some items specific to the Division of Depositor and Consumer Protection. Mr. Pearce began by mentioning that DCP also reviewed the pre-exam planning process in an effort to make that process more efficient and effective while not altering supervisory standards. Mr. Pearce stated that DCP was able to improve the risk focus and do more data collection offsite at the beginning of the examination process, so that, when examiners arrived at the bank for the onsite portion, they would have a deeper knowledge of the individual bank and that would really help risk-focus the examination and be more efficient onsite. Mr. Pearce also mentioned that DCP looked at the pre-exam planning process to see if it could be improved. Mr. Pearce reported that they were able to identify recommendations that will help refine the pre-examination process and reduce the documentation and information required up-front. Mr. Pearce stated that DCP is recommending a two-step process at the pre-exam planning phase so that questions and information can be gathered on the front end and then subsequently come back with a second request that is more tailored. That way, he explained, there can be less non-relevant documents collected.

Mr. Pearce next mentioned that there have been updates to the technical assistance video series including updates on CFPB's ability to repay rule on qualified mortgages, specifically tailored to community banks and community bankers. Mr. Pearce welcomed any feedback on the videos.

Following the presentation, there was a period of discussion concerning issues raised by the panel.

Ms. Ryan next introduced Doreen Eberley, Director, RMS, and James Watkins, Deputy Director, RMS, to provide an update on de novo banks. Ms. Eberley began the discussion by mentioning two outreach initiatives that came out of the Community Banking conference earlier this year. The first initiative, she stated, was a series of roundtable events with proposed

organizers of de novo institutions and other interested parties about the process of applying for deposit insurance. The second initiative, she stated, was the roundtable meeting with universities and colleges offering banking degrees, to further explore ways to partner the schools with community banks that are in need of new bankers. Ms. Eberley then introduced Mr. Watkins to provide an overview of the de novo roundtables.

Mr. Watkins began by mentioning the schedule of events including the first event held on September 28th in San Francisco, followed up by an event in New York on October 13th. Both of these events, Mr. Watkins explained included roughly forty (40) industry participants, either groups of potential community bank applicants or, in some cases, consulting firms, law firms, and other interested parties. During those events, Mr. Watkins explained, the view was expressed that community financial institutions are the very core of the U.S. financial system and that they are the vehicle through which a large segment of consumers, small businesses, and communities gain access to credit and to banking services. Mr. Watkins went on to explain that in the post-crisis period, community banks have faced unique challenges. However, community banks remain optimistic with respect to the future of community banking and its essential function in our financial system.

Mr. Watkins next explained that with the long history of community banking, new entrants to the sector have played a role in preserving the vitality of the industry. He mentioned that, along with supporting community banks operating in today's environment, the FDIC is supportive of the formation of new financial institutions and welcomes applications for deposit insurance. Mr. Watkins stated that the FDIC believes that de novo institutions fill important gaps in their communities and local banking markets providing credit and services to communities that are sometimes overlooked by larger institutions. Historically, Mr. Watkins mentioned, the rate at which new charters have been added to the industry has been highly cyclical, with new institutions highly correlated to periods of economic expansion and strong financial performance of the banking industry as a whole. Mr. Watkins also pointed out that FDIC researchers have found that newly-insured banks can be more susceptible to failure under adverse economic conditions, with a failure rate that can be twice that of established institutions. In this way, he stated, these findings underscore the importance of promoting the formation of new banks and establishing an effective application process and supervisory program that will ensure new banks adopt appropriate risk management practices and strategies and ensure that their prospects for long-term success are favorable. Mr. Watkins stated that the FDIC expects chartering activities to pick up as economic conditions continue to improve and normalize. Mr. Watkins pointed to pockets of de novo activity and increased interest in areas with favorable economic activity or in geographies that have experienced industry exits. Mr. Watkins added that the FDIC welcomes applications for deposit insurance and recognizes that applications require FDIC staff to be knowledgeable and available to process and analyze proposals as the industry submits them. Therefore,, he stated, each FDIC regional office has designated subject matter experts and/or application committees to serve as points of contact for deposit insurance applications.

Mr. Watkins next mentioned that the outreach agenda includes topics that have been outlined in the FDIC's statement of policy on applications for deposit insurance. The FDIC policy, Mr. Watkins added, references the statutory factors that the FDIC must favorably resolve

in order to approve applications. Mr. Watkins next mentioned that the agenda for the sessions covers topics and discussions relating to the application process and addresses specific filing requirements for the application, the review steps, and the points of contact for each agency. He went on to state that the outreach events also discussed the formation of the business plan, its subsequent development, and the various statutory factors considered when the business plan is reviewed by the FDIC, including capital and earnings.

Mr. Watkins concluded by stating that the FDIC is committed to working with, and providing support to, any group with an interest in starting a de novo bank, and will be issuing a deposit insurance handbook to help guide proponents and organizers through the application process. Mr. Watkins stated that the handbook is being updated to draw on some of the feedback obtained from the outreach sessions and there is ample room in the industry for new bank entrants with sound funding and well-conceived business plans to serve local markets.

Ms. Eberley then acknowledged the contribution of Member Tolomer whose suggestion at the Community Banking Conference in April inspired the idea for holding a de novo panel with successful de novo bankers to provide greater insight into the process. Ms. Eberley went on to mention that a list was kept of all of the questions that came up during the sessions and RMS is incorporating answers to those questions in the de novo handbook. Ms. Eberley also mentioned that there has been an increase in de novo activity, specifically, since the last meeting of the Advisory Committee. In this regard, she stated that the FDIC has received three new de novo applications along with a several more non-traditional de novo deposit insurance applications and there have been a number of pre-filing meetings around the country.

Member Hanrahan commented that the de novo roundtable was a great event. He added that many of the most powerful anecdotes were examples of what not to do. With regard to the question of how much capital is required for a de novo applicant, Member Hanrahan thought that the answer given (by the FDIC) at the de novo roundtable was ideal, which was to show the FDIC a credible business plan that maintains a Tier I leverage ratio of 8 percent that the organization can be profitable at, and that is the right capital level.

Member Tolomer agreed that the roundtables were a positive experience and went on to mention that an important issue with de novo institutions is managing investor expectations, to which Member Scully agreed. Ms. Eberley then commented that the issue of managing investor expectations will be covered in the de novo handbook.

Member Turner asked whether the heightened failure risk to de novo institutions affects their deposit insurance pricing. Mr. Watkins stated that de novo institutions do not have an increased premium. Ms. Ellis added that de novo institutions are assessed at a flat rate for the first five years. Ms. Ellis further added that the rate currently is nine basis points which is in the top of risk category one.

Member Beard asked whether there has been a study done on the slide of equity from the banking institutions because of a perception that the profit is not the way that it used to be. Ms. Eberley responded by stating that she was unaware of any such study but, she explained, by studying CallReport data, a significant amount of capital was introduced into the banking

industry, even during and post-crisis. Ms. Eberley further explained that although capital may not have been coming into the industry in the form of new de novo institutions, it was being introduced in the form of supporting existing institutions, some through changes of control with new capital coming with a new owner, some from investors purchasing troubled institutions and going for a change of control.

Mr. Watkins then made an observation that generally the price of equities in relation to book value has improved for U.S. financial institutions and this suggests another possible reason for the increase in interest in forming a de novo institution as opposed to investing in an existing bank. Member Tolomer agreed that this was a good point.

Ms. Eberley next introduced Mr. Watkins to discuss the initiative related to the education and development of the next generation of community bankers. Mr. Watkins began by sharing some of the commentary received from bankers at the April, 2016 Community Banking Conference about the challenge of attracting and training the next generation of community bankers. Mr. Watkins reported that bankers spoke about the issue as a “talent crisis” with fewer colleges and universities offering community banking programs and community banking degrees.

Mr. Watkins stated that, on October 27, 2016, the FDIC hosted a meeting in Dallas, titled “Developing Tomorrow’s Community Bankers,” which involved a discussion between educators and the industry. Chairman Gruenberg was at the meeting along with representatives from both the banking community and the academic community. Mr. Watkins reported that the purpose of the dialogue was to explore community banking educational programs and to identify and discuss challenges and best practices of those programs in the experience of the participants. Mr. Watkins further reported that the groups represented 10 colleges and universities from the states of Arkansas, Indiana, Mississippi, New Mexico, South Carolina, South Dakota, and Texas. Also attending, Mr. Watkins reported, were representatives from the American Bankers Association, Independent Community Bankers of America, and Commissioner Charles Cooper with the State of Texas. Mr. Watkins described the meeting as being both productive and interesting with the schools expressing a strong interest in partnering opportunities, internship opportunities and continuing to help attract students to banking and exploring additional steps that they could possibly take as well. Mr. Watkins described one suggestion which would be to develop a directory of schools and colleges offering programs and establish points of contact. Mr. Watkins stated that some of the schools discussed having advisory panels for the schools themselves with community bankers, and this would be a good way to understand the needs of community bankers and attract students.

Following Mr. Watkins presentation, Mr. Watkins and Ms. Eberley welcomed comments and questions from the Committee.

Member Hartings asked whether the FDIC has studied graduate degree programs focused on banking. Mr. Watkins responded that the American Bankers Association helped sponsor one such graduate degree program, so they were represented in that regard. Mr. Watkins stated that these graduate degree programs generally help to educate and provide training for individuals that are already in banking.

Member Hartings asked whether the FDIC has made any of their instructors available to colleges and universities. Mr. Watkins felt it was a great question and deserved further consideration. Member Thompson asked about the future of the program and what community bankers can do to help further promote it. Ms. Eberley responded that it may be beneficial to facilitate regional meetings to that end as well as working with local universities and local bankers and state banking associations to partner together.

Chairman Gruenberg mentioned that the program is an initial engagement designed to begin the process of becoming more informed about what is available, how the programs are structured, who the students are that participate and what the possibilities are going forward. Chairman Gruenberg mentioned examples of possible development such as opportunities to expand the working relationships existing programs have with their banking communities and how well-informed are bankers about the programs. The Chairman pointed out that there currently is no national directory of all colleges, universities and business schools that offer banking programs. This, the Chairman explained, operates as an information gap—a gap the FDIC may be able to fill.

Then the Committee took a mid-morning break at 10:31 a.m. and resumed at 10:55 a.m.

Ms. Ryan then called on Diane Ellis, Director, Division of Insurance and Research and Matt Green, Associate Director, Division of Insurance and Research to provide the Committee with an update on FDIC assessment rates.

Ms. Ellis introduced Mr. Green to make a presentation on the significance of crossing the 1.15 percent threshold in the Deposit Insurance Fund (“DIF”), why it is important, and what changes that is going to bring about.

Mr. Green then reported that the DIF balance stood at \$77.9 billion on June 30, 2016, which is an increase of \$2.8 billion from the previous quarter. Ms. Green also reported that the DIF reserve ratio, which is the fund balance as a percent of estimated insured deposits, rose to 1.17 percent June 30th from 1.13 percent on March 31st. Mr. Green stated that, as a result of this, pursuant to regulation, three major changes in assessments begin the quarter after the reserve ratio first reaches 1.15 percent. Therefore, Mr. Green explained, the changes took effect beginning in the third quarter of 2016, and banks will see these changes in their third quarter invoices.

Mr. Green then explained the three major changes. First, he stated, overall initial assessment rates for all institutions have declined from a range of 5 to 35 basis points to a range of 3 to 30 basis points. Mr. Green explained that the law requires banks that have total assets of \$10 billion or more to bear the cost of the increase in the reserve ratio from 1.15 percent to 1.35 percent. In this way, he explained, the second change is that large banks are now subject to temporary assessment surcharges and at this time, the projection is that the surcharge will last eight quarters and will total approximately \$10 billion. Additionally, Mr. Green explained, small banks will eventually receive assessment credits for the portion of their assessments that contributes to the increase in the reserve ratio to 1.35 percent. The FDIC is projecting total

credits of approximately \$1 billion, and the FDIC will apply these credits to reduce the assessments of small banks when the reserve ratio is at or above 1.38 percent. The third change, Mr. Green explained, involves a revised method to determine risk based assessment rates for banks with less than \$10 billion in assets, which also went into effect in the third quarter of 2016. This revised method was developed using data from the recent crisis, post-crisis years, and earlier periods in order to better reflect risks to the insurance fund. He stated that, under the revised method, total assessment revenue collected from small banks is approximately the same as it would have been under the prior risk based pricing method. So, Mr. Green explained, as a result of these assessment changes, most community banks will see reductions in their deposit insurance assessments. Mr. Green stated that the FDIC is estimating that assessments will decline for 93 percent of institutions that have less than \$10 billion in assets and in aggregate, quarterly assessments paid by small banks are expected to decline by roughly one third.

Mr. Green concluded his remarks by stating that banks are not going to be required to report any additional data because of these assessment changes and they can estimate their assessment rates using the FDIC's online calculator. Mr. Green added that the FDIC also has an assessments helpline to answer any questions about these changes and then opened the discussion up to comments and questions from the Committee.

Member Howard asked for clarification on whether the amount of premiums that will be paid into the fund by small banks will increase. Mr. Green responded by stating that the amount of premiums paid into the fund by small banks will decline by approximately one third. Member Hanrahan asked for clarification and perhaps elaboration on applying credits to the bank. Mr. Green responded that a bank's premiums cover the losses, expenses, and regular growth of insured deposits to maintain a reserve ratio at 1.15 percent. So, Mr. Green explained, the FDIC will be crediting back the portion that contributes to the increase. Mr. Green then provided an example by explaining that the forecast is that the reserve ratio will reach 1.35 percent in 2018 and the quarter where that goal is reached, the minimum target for the reserve ratio, will calculate .2 percent of insured deposits which is the difference between 1.15 percent and 1.35 percent, which for the sake of the example, is approximately \$15 billion. Then Mr. Green explained, looking at the \$15 billion a portion of that comes from the surcharges paid by large banks which might be around \$10 billion, leaving \$5 billion coming from the regular assessments of all banks that contributed to the increase in the reserve ratio. Mr. Green went on to explain that of that \$5 billion, a portion of that comes from small banks, which currently, is around 20 percent, so about \$1 billion, which is consistent with the current estimate.

Ms. Ellis added that the big wildcard is insured deposit growth. Ms. Ellis explained that if insured deposit growth is rapid, then there will be the need for a greater portion of regular premiums to cover that or if there is a big failure, more regular premiums are going to be needed to cover that. Conversely, she explained that if insured deposits growth slows or there are even fewer failures, then more of the regular premiums would be returned in the form of a credit.

Member Howard asked Ms. Ellis if she could explain the revised methodology for small banks. Ms. Ellis responded that the new assessment system sort of looks and feels like the old assessment system in the sense that it is a set of financial ratios and CAMELS ratings that are used to calculate an assessment rate. The difference, Ms. Ellis explained, is that underlying the

choice of those ratios and the weights placed on them there is a change in the model. Post crisis, she further explained, the FDIC wanted to update the model to take advantage of lessons data from the crisis and so the FDIC changed to a failure projection model. Ms. Ellis stated that based upon experience and all the data collected, what is the likelihood that a community bank is going to fail over a three year time horizon.

Ms. Ryan then introduced the next panel to discuss consumer compliance issues, particularly the affordable mortgage lending guide, flood insurance issues, consumer compliance rating systems, and the Military Lending Act. To discuss these issues, Ms. Ryan introduced Mark Pearce, Director, DCP, Luke Brown, Associate Director, DCP, and Janet Gordon, Associate Director, DCP.

Mr. Pearce began by mentioning that. Recently. DCP hosted a youth savings symposium which, he explained, is a pilot project where the FDIC brings bankers and schools together to help educate young people about financial matters as well as pairing them up with actual accounts in insured depository institutions. Mr. Pearce then introduced Associate Director Janet Gordon to provide an update on helping community bankers serve the mortgage credit needs of members of their communities.

Ms. Gordon began by introducing the affordable mortgage lending guide, an FDIC publication, and the Affordable Mortgage Lending Center, which is an online resource. Ms. Gordon stated that there are three parts to the online resources. Part one, she explained, covers Federal and government-sponsored enterprise programs. Part two, she stated, covers state Housing Finance Agency programs. The third part, she continued, will be a guide on the Federal Home Loan Bank programs and will be published by the end of the year. Ms. Gordon stated that the links to access these resources are at [FDIC.gov/mortgage\\_lending](http://FDIC.gov/mortgage_lending).

Ms. Gordon explained that the tools are designed to be resources for community banks and others who want an authoritative overview of affordable mortgage lending programs. She went on to explain that they also provide straightforward information on how banks can access the programs, whether as an originator, a correspondent, or a direct seller. Ms. Gordon then explained the purpose behind the guide which is to promote the widespread availability and effective use of safe, affordable, and sustainable products from insured depository institutions in communities to better connect banks and communities. Ms. Gordon continued to provide further background leading up to the development of the resource and described the guide as comprehensive, covering guarantee, loan purchase, tax credit, subsidy programs, various home ownership education requirements, Federal GSE, and state programs. Finally, Ms. Gordon welcomed any comments or feedback.

Mr. Pearce then introduced Luke Brown, Associate Director, Policy Group, to talk about some of the recent regulatory changes in consumer compliance.

Mr. Brown stated that he would discuss several consumer compliance topics, including flood insurance, a ratings guidance update, and a summary of the Military Lending Act implementation work. Mr. Brown explained that very recently the FDIC and several other agencies announced a joint notice of proposed rulemaking related to flood insurance. Mr. Brown

further explained that the proposal would specifically require that lenders accept flood insurance policies that meet the definition of private flood insurance under the Biggert-Waters Act.

Mr. Brown explained that Federal flood insurance statutes require regulated lending institutions to ensure that flood insurance is purchased in connection with loans secured by properties located in areas having special flood hazards. Mr. Brown further explained that agencies believe that the congressional intent of Biggert-Waters was to spur a private flood insurance market. In this way, he stated, under Biggert-Waters, lenders must accept in satisfaction of the mandatory purchase requirement, policies issued by private insurers to satisfy the requirements of the Act. Mr. Brown explained that one of the key issues was related to concerns about how the lender verifies that the private policy actually meets all of the requirements. Mr. Brown further stated that in reference to this concern, the agencies included in the new proposal a compliance aid that assists consumers and lenders in determining whether and how a policy actually meets the private flood insurance requirements. Mr. Brown stated that the compliance aid would allow an insurance company to self-identify that the policy complies with private flood insurance requirements and then the lender would be required to accept that policy pursuant to Biggert-Waters.

Mr. Brown next provided an update on the interagency consumer compliance ratings. The rating system is used by examiners to evaluate banks' adherence to the consumer compliance laws and regulations and based on their review, examiners assign a rating to each financial institution. Mr. Brown stated that the interagency revision would more fully align the rating system with the way an examination actually occurs. He explained that since the public comment period ended last July, the FDIC has been working in earnest to get the proposal completed by the end of the year.

Next, Mr. Brown provided an update on the Military Lending Act ("MLA"). The MLA was issued by the Department of Defense in July of 2015 and expanded financial protections provided to service members and their family. It also addresses a wider range of credit products that fell outside of the scope of the preexisting rule, the rule to finance consumer credit consistent with credit that is subject to Truth In Lending requirements, so much broader than the previous definition. Mr. Brown stated that the new rule became effective in October 2016. He further explained that the MLA caps the military annual percentage rates on covered transactions at 36 percent. Additionally, Mr. Brown stated, there is a safe harbor and so under the rule it grants lenders a safe harbor for the purpose of verifying eligibility of service members and their family. Mr. Brown next stated that on October 17, 2016, the FDIC issued a Financial Institution Letter (FIL-65-2016), announcing the release of certain interagency MLA examination procedures, which the FDIC worked on collectively with other agencies to ensure consistently. FDIC examiners, Mr. Brown stated, will use these procedures to evaluate banks' compliance with the rule.

Mr. Pearce then invited any comments and questions from the Committee following which there was a general discussion of issues raised by the panel.

At 11:41 a.m. the Committee broke for lunch and resumed at 1:15 p.m.

Ms. Eberley began the afternoon session by introducing Rae Ann Miller, Associate Director for Policy and Shannon Beattie, Section Chief, Accounting and Disclosure Unit, in RMS who would lead a discussion of developments in the risk management policy area.

Ms. Miller began the discussion with an overview of the proposed third party lending guidance. Ms. Miller stated that the guidance was issued for public comment in July 2016 under FIL-50-2016. Ms. Miller stated that there were ten specific questions asked in that release, focusing on scope of the guidance, the risks enumerated, risk management programs, and supervisory and examination considerations. Ms. Miller explained that the proposed guidance provides information on third party lending and supplements the longstanding safety and soundness in consumer compliance principles that were addressed in the guidance for managing third party risk. Ms. Miller further explained that the proposed guidance indicates that a bank's board and senior management are ultimately responsible for managing third party arrangements as if the activity were handled within the bank. Additionally, Ms. Miller stated, the proposed guidance points out that managing and controlling risks can be challenging when origination volumes are significant or there are numerous third party relationships involved. Ms. Miller stated that the proposed guidance defines third party lending as "a lending arrangement that relies on a third party to perform a significant aspect of the lending process." She briefly covered the various ways the guidance might cover a third party arrangement. Then she explained in originating loans through third parties, i.e. for example, arrangements where institutions partner with an entity that lacks the necessary licenses or charter to lend on its own behalf in various states. Next, she stated that the guidance covers originating loans jointly with third party lenders, i.e. for example, agent relationships in which the institution authorizes the agent to originate loans on its behalf in some situations. The third way, Ms. Miller explained, is using platforms developed by third parties, i.e. for example "white label" lending products in which the third party provides an end-to-end platform service for the institution. Ms. Miller stated that the proposed guidance does not single out any particular type of third party lending arrangement, but regardless of the particular type of third party lending relationship, institutions that rely on a third party to perform a significant aspect of the lending process are expected to have a robust risk management framework in place to address the associated risks.

Ms. Miller stated that the proposed guidance supplements and expands on the 2008 guidance principals by establishing more specific expectations on how those principles should be applied in third party lending activities. She next mentioned that consistent with existing practices, the proposed guidance indicates that institutions engaging in significant lending activities through third parties will generally receive increased supervisory attention. Ms. Miller explained that under the proposed guidance, arrangements will be considered significant if they have a material impact on revenue, earnings, expenses, capital, involve large lending volumes in relation to the bank's balance sheet, involve multiple third parties, or present material risk of consumer harm.

Ms. Miller next provided an update on the Economic Growth and Regulatory Paperwork Reduction Act of 1996 ("EGRPRA"). Ms. Miller stated that EGRPRA requires that the banking agencies and the FFIEC review their regulations at least once every ten years with the purpose of identifying outdated or unnecessary regulations and to consider how to reduce regulatory burden on insured depository institutions, while at the same time ensuring their safety and soundness and

that of the financial system. Ms. Miller next stated that the agencies are also required to categorize and publish the regulations for comment and to submit a report to Congress that summarizes any significant issues that are raised by the commenters. Ms. Miller reported that the FDIC has received over 250 written comments from the four Federal Register notices and numerous comments from over 1,000 participants in the outreach sessions. Ms. Miller stated that there are six areas that received the most comment in that process, and those were the examination cycle, appraisals and evaluations, Call Reports, Bank Secrecy Act and anti-money laundering laws, the Community Reinvestment Act, and capital. Ms. Miller indicated that the agency is continuing to review comments in each of the areas and has already taken action in several areas. One example, Ms. Miller pointed out, was the FDIC issuing an interim final rule to make the 18-month examination cycle available to more community banks at an increasingly eligible threshold for well-rated and well-managed institutions from 500 million in total assets up to one billion dollars. With respect to appraisals and evaluations Ms. Miller stated, the agencies issued an interagency advisory on use of evaluations in real estate related transactions.

Ms. Miller next stated that to assist bankers in complying with the revised capital rules, the FDIC published a community bank guide, released an informational video, and conducted a number of face-to-face banker information sessions in each of the six regions to discuss the revised rules most applicable to community banks.

Ms. Shannon Beattie then provided an update on Consolidated Report on Condition and Income (“Call Report”) efforts, specifically with emphasis of the Call Report for small institutions. Ms. Beattie reported that the FDIC and the other banking agencies continue to move forward with the FFIEC’s community bank Call Report burden reduction initiative. In this regard, she stated that the FFIEC did reach a significant milestone in this initiative in August when it announced the issuance and invited comment on the proposal for the new streamlined Call Report for small eligible small institutions, and those are institutions with domestic offices only and less than \$1 billion dollars in total assets. Ms. Beattie stated that the eligible small institutions represent about 88 percent of all insured institutions. The proposed new report, she explained, is intended to ease reporting requirements and reduce reporting burden for small institutions. Further, Ms. Beattie stated that the overall proposal also includes certain proposed burden reduction revisions to the other two existing Call Report forms which are FFIEC 031 for institutions with domestic and foreign offices, and FFIEC 041, which is for institutions with domestic offices only. Ms. Beattie explained that the new FFIEC 051 Call Report and the revisions to the other two existing Call Reports are proposed to be implemented as of March 31, 2017. Ms. Beattie stated that the existing 041 report served as the starting point for developing the proposed 051 report for the smaller institutions which reduces the length of the Call Report and removes a significant number of the data items currently included in the 041 Call Report. Ms. Beattie also stated that the changes also include the addition of a supplemental schedule containing indicator questions on certain complex and specialized activities such as derivatives, the use of the fair value option, and the servicing, securitization, and sale activities. Further, she explained that the supplemental schedule provides a basis for removing all or part of six schedules and other data items that currently exist in the 041 report. Ms. Beattie also stated that the proposal notes that eligible small institutions would have the option to file the 041 Call Report rather than the 051 to allow timing for transition so the 051 is expected to be effective for March 31, 2017, but institutions could opt to continue to use the 041 as long as needed.

Ms. Eberley then welcomed comments and questions from the Committee.

Member Howard asked whether there had been progress made on equity securities as related to Call Reports. Ms. Eberley responded that the issue is still in line for discussion. She explained that the Task Force on Reports has positioned its workflow to get the reduced content Call Report form out first, then go through the rest of the line items. Ms. Eberley further explained that given there is still some time before the ruling goes into effect that issue is further along in the workflow, but is on the list of changes to be made.

Member Hartings applauded the FDIC's efforts to reduce Call Report burden and asked how many pages and instructions the 051 report has. Ms. Beattie responded by stating that the 051 Call report will be reduced from 81 pages down to 65 pages and the FDIC is in the process of reducing the Call report instruction book.

Chairman Gruenberg then asked if Ms. Eberley could provide an update on the new Credit Expected Loss Standards ("CECL") for Allowance for Loan and Lease Losses ("ALLL") Ms. Eberley responded that as part the FDIC's ongoing initiatives for community banking, a webinar on CECL with the Independent Community Bankers Association was conducted back in August. Ms. Beattie added that the Federal Banking regulatory agencies are coordinating Frequently Asked Questions on CECL that the FDIC hopes to publish before the end of the year.

Ms. Eberley then asked if the Committee had specific comments or questions. Member Hartings asked whether the FDIC has communicated with any major core providers. Ms. Beattie responded by stating that the FDIC has met on an interagency basis with some of the service providers to get an idea of what services they would offer and what data points they would be looking for. She stated that the conversations are in the early stages of digesting the CECL standard and what the potential requirements are. Ms. Beattie commented that because institutions can chose what model is appropriate for their individual loan portfolios, then it will depend on what type of model will be used and that will drive what data is needed. Member Hartings followed up with a question of how that will work with external auditors. Ms. Beattie further responded that the FDIC has been reaching out to the audit firms to discuss some of the challenges and obstacles with the CECL standard. Member Hartings then asked if the FDIC would be providing a model and Ms. Beattie responded that there is no intention of providing a model at this point. Ms. Eberley added that FDIC guidance will discuss the available options.

The last panel of the day consisted of a general roundtable discussion concerning general issues and concerns the Committee would like to discuss. Some of the topics covered included the cybersecurity assessment tool, regulatory issues related to CRE concentration, the Community Reinvestment Act, succession planning, third-party technology service providers, and other regulatory oversight issues.

Member Beard asked about recent negative publicity regarding a certain large institution's cross-selling practices, and whether there might there be the possibility of increased rules or requirements brought to bear on community banks as a result thereof. Ms. Eberley responded that there is no plan at this point for new rules or new procedures and the negative publicity has not changed examiner guidance. Ms. Eberley also reminded the Committee of the

Statement of Policy on incentive compensation that is already in place that addresses a bank's need to balance risk versus reward and volume-based compensation. These fundamentals, Ms. Eberley stated, have already been built in to the examination process.

Member Hartings thought it would be important to include CECL and the Call Report updates on the agenda going forward. Member Hartings next asked about the cybersecurity assessment tool ("CAT") and if there was a sense about how many banks in the industry have implemented it. Ms. Eberley responded that she did not have a specific number, but through feedback she received at the Federal Financial Institutions Examination Council, she reported that it has been well received.

Ms. Eberley next commented that recently the FDIC issued the Information Technology Risk Examination (InTREx), which is a new examination work program for information technology. Ms. Eberley commented that the work program has been redesigned around the four components of the information technology rating. She explained that one way to look at it is that the risk assessment is something banks have to do and the tool is one thing to help the banks accomplish it.

Member Scully then asked about the possibility of increased regulatory scrutiny regarding higher Commercial Real Estate ("CRE") concentrations. Ms. Eberley responded that the FDIC regularly works on the CRE issue on an interagency basis. Ms. Eberley reported that the industry has been seeing some rapid growth in already concentrated portfolios, particularly in the area of Acquisition, Development and Construction ("ADC") lending and wholesale funding. Based on this, Ms. Eberley reported that in December of last year, interagency guidance was issued reinforcing the importance of a bank having strong capital and a strong allowance (ALLL) if the bank is concentrated. Ms. Eberley reminded that while there is not a prohibition against CRE concentrations, the community bank must be cognizant of the vulnerabilities on the balance sheet. Ms. Eberley indicated that the FDIC has emphasized with its examiners to focus on best practices such as the importance of underwriting and credit administration, including not just risk management practices, but also paying attention to what is happening in the marketplace, understanding it, how the bank limits risk, having discussions at the Board, stratifying the portfolio, and stress testing the portfolio.

Member Dakri then asked if there had been any thought given to separating construction loans by owner occupied construction loans versus true speculative construction loans. Ms. Eberley responded that should be built into the bank's risk management practices around concentration.

Member Howard then asked about the Community Reinvestment Act ("CRA") and whether there could be a discussion that could be added to future agendas regarding issues related to the CRA. Member Howard commented that community bankers are finding it increasingly difficult to adhere to the requirements. Mr. Pearce commented that was helpful feedback and the FDIC and other agencies are evaluating comments made as part of the EGRPRA process.

Member Thompson asked if there might be a plan to hold a community banker's forum for the various regions. Chairman Gruenberg responded that the FDIC has received questions about that and one of the challenges in doing it annually involves the considerable work that goes into producing the event. That said, the Chairman indicated that certainly on a biannual basis it is reasonable to do.

Member Menon then asked about issues related to marijuana businesses and banking. Ms. Eberley commented that as long as there is a conflict between Federal and state law, the FDIC remains bound by Federal law. Ms. Eberley then referred Member Menon to the guidance issued by FinCEN on the topic. Lastly, Ms. Eberley commented that there has been continued discussion with the regulators and FinCEN on the issue and the discussions will continue.

Member Thompson then asked about the issue of management succession. Chairman Gruenberg commented that one of the key issues for community banks going forward is succession planning and he felt that perhaps at the next meeting a discussion could be organized around succession planning. Following Member Thompson's comment, there was an extended discussion about management succession issues related to community banking.

Member Paine then asked about technology service providers and what role the FDIC plays in examining them. Ms. Eberley responded that the FDIC's examination authority comes from the Bank Service Company Act which generally states that the FDIC has the authority to examine companies that provide services to banks. This is performed, Ms. Eberley stated, on an interagency basis.

Member Hanrahan mentioned that it might be useful to include in the de novo handbook a section outlining best practices for dealing with bank vendors.

Member Thompson then asked about the possibility of expanding the Community Bank Advisory group meetings to the local or regional level. Chairman Gruenberg commented that he thought the idea of having regional group meetings was interesting and warranted further consideration. However, it would have to be balanced against the amount of resources involved in administering the meetings.

Member Emmons commented on compromised credit and debit cards and the role they play in security. Member Scully stated that card security is now a permanent cost of doing business. There was thereafter, a discussion concerning issues related to credit and debit card security. Following that discussion, the roundtable was brought to a close.

In bringing the meeting to a close, Chairman Gruenberg emphasized that it was an excellent meeting, and that he would welcome any feedback from Committee members on issues they may like to include on the next meeting agenda. Chairman Gruenberg then thanked the members for their participation and there being no further business, the meeting was adjourned at 2:49 p.m.



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Robert E. Feldman  
Executive Secretary  
Federal Deposit Insurance Corporation  
And Committee Management Officer  
FDIC Advisory Committee on Community Banking

Minutes  
of the  
Meeting of the FDIC Advisory Committee on Community Banking  
of the  
Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

November 3, 2016 – 9:00 A.M.

I hereby certify that, to the best of my knowledge, the attached minutes are accurate and complete.



Martin J. Gruenberg   
Chairman  
Board of Directors  
Federal Deposit Insurance Corporation